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## Editorial Comment

### *Public Relations*

Great stress is laid by the profession on the independence of its members. Our codes of ethics are the evolution of many particular incidents which have resulted in the drafting of rules. These codes are well-known to practitioners but not so well-known to clients and to others outside the profession. It can be assumed that clients will learn them by experience through the constant example of their auditors. Other persons outside the profession will not become aware of them in this way, however, and it seems that a direct effort should be made by the profession to put objectively before the public generally not only its aims and ideals but also details of the service it can render and how it is rendered.

This view is the outcome of what seems to be an inevitable result of a campaign of betterment. Public accountants have taken a leading part in the effort to put before shareholders, employees, creditors, government agencies and so on, full particulars of the affairs of public corporations which they audit. They have not limited themselves to the presentation of the accounts and accounting details but have assisted in great measure in the production of

attractive and informative reports by the directors and officers of the corporation concerning details not apparent from a review of the accounts. They have thus brought themselves and the profession into the limelight and are now subject to the public gaze to a degree which perhaps surprises even themselves.

Naturally, stones are thrown and the throwing of stones is not ordinarily a precise skill. The thrower cares little how good his aim and on occasion will confess himself that he did not have his feet planted solidly when he threw. Frequently he does not pick out a clear target, feeling that if he can throw enough stones in a single general direction, one or two may strike and cause some irritation to the target.

One stone which has caused irritation recently is an article entitled "How Much Did We Make This Time?" by Harold Wolff and printed in the April 14th issue of the New Republic. This is a discussion, far more derogatory than complimentary, of annual reports issued by corporations. These reports are attacked from cover to cover. The good faith of all concerned in their preparation is villified and the author is content to leave it at that. No attempt is made to explain the purpose of the whole document or the parts that are played by various officers, accountants and so on in their respective spheres of influence. One quotation will suffice to give the tenor of the whole article:

"For those who want to learn how to read annual reports, a guide is offered by H. A. Finney, Ph.B., C.P.A., a noted accountant and teacher with long experience in the preparation of these documents. He says 'Read them with a grain of salt' and adds these warnings:

1. Some men are liars.
2. Two equally able and equally honest accountants may differ widely.'

"First, as to the ugly matter of lying. Every annual report bears some kind of 'certification'. This is a sort of invocation by the accountants who audit the report, and on the surface, sounds like a promise to tell the truth, the whole truth, and nothing but the truth, so help them God.

"On close examination, the letter of certification often reveals what the auditors do not wish to be held responsible for. Thus in the current GE report the auditor's letter says: 'We have examined the balance sheet of the General Electric Company—without making a detailed audit of the transactions'. This rather frank statement points up the fact that the independent auditors who prepare the annual report often merely review the company's figures and see to

it that they have made no mistakes in arithmetic. And, at that—in the case of GE—they want it known that they did not confirm the details; they saw only the gross totals after the corporation's high-level accountants had finished setting the figures."

One wonders how someone who knew so little about the subject could have such stuff accepted for publication; one wonders how the financial editor of the Toronto Daily Star could bring himself, without making any comment, to giving up, on April 14th, a whole column to reproduce a series of quotations from the article under a two column heading "Read Those Annual Reports with a Grain of Salt—Expert. By Beland Honderich, Financial Editor". In the whole column there are hardly a hundred words "by Beland Honderich, Financial Editor" and they are merely introductory.

If the financial editor of one of the most widely read Canadian daily newspapers feels that Mr. Wolff's comments are fair—and he must think so or he would have added some thought of his own—we have a job to do right here at home and we can leave Mr. Wolff to others nearer to him.

Against that kind of aimless and vicious stone-throwing, we have a report in The Journal of Accountancy that in a survey of stockholders' opinions the research division of Hartwell, Jobson and Kibbee found that two-thirds of the respondents read the auditor's report, 59 per cent thought it guaranteed the financial statement and only eleven per cent did not think so. The American Management Association says of this:—

"There appears to be room for an explanation of the auditor's report, what it means, what it intends to show and what it does not show—. Some reference might be made to the requirements and assumptions in accordance with which the auditor's report was prepared,—the whole matter needs more consideration."

We agree entirely with The Journal of Accountancy that both the one-third of the stockholders who did not think the auditor's report worth reading and the great majority who thought it guaranteed the financial statement need education on the subject. But to think that we have to start with a financial editor —!

How should this education be carried on? Mr. John L. Carey, Secretary of the American Institute of Accountants in an article entitled "The Realities of Professional Ethics" printed in the Accounting Review, April, 1947 gives us this thought,—

"The remedy lies not in distributing copies of the code of ethics through the mail, although perhaps even more of that would help some. Practitioners should, I think, take every natural opportunity to inform their clients of the rules of conduct to which they have subscribed. But the real remedy lies in a deeper understanding among accountants themselves of the essential meaning of the rules, their background, and the purpose for which they were adopted. Such an understanding, coupled with active enforcement of the rules, will encourage the kind of behaviour on the part of the public accountants generally, which will impress on all those with whom they come in contact the accountant's independence, integrity and sincerity. This kind of public relations, the example of thousands of individuals in their daily lives, far surpasses in effectiveness all the speeches that could ever be made."

It is also distressing to find that a member of our government would not appreciate the integrity, total independence and impartiality of the members of our Dominion Association. A very excellent presentation of the facts leading up to and surrounding the appointment of auditors for Canadian National Railways and the Trans-Canada Airlines (as appears in Hansard of March 31st, 1947, pages 1955 to 1970) was marred by the drawing of a comparison on page 1959 as to the independence of the present auditors as opposed to the auditor general. We quote:

"I have another and far better and deeper reason for the contention that the auditor general can make a better report than any civilian auditor, and that is his independence. Once appointed under the great seal of Canada, he is responsible only to parliament. He can feel as free as he likes to make criticism of what he thinks is wrong, and it would take a very great dereliction of duty on his part for both houses of parliament to pass an address requiring his removal. Because of that independence, he can make the sort of reports he has made for the last four or five years.

Compare that with the appointment of a civilian auditor by act of parliament—not by resolution of parliament but by act of parliament. He must be very grateful to the government of the day for that appointment. I, of course, as a supporter of this government, have every confidence that the present civilian auditor appointed by the government is doing a responsible job."

The suggestion that any member of our profession might be influenced in his judgment of facts and the reporting thereon by reason of any feeling of gratitude to a client for his appointment is uncalled for.

In conclusion it would be well to quote the remarks made in 1940 in reporting on "Professional Ethics" by Mr. Edward B. Wilcox, then President of the American Institute of Accountants:—

"The accountant has a contractual relationship with his client who, he knows, may cease to employ him, but he must nevertheless deny the wishes of his client if they conflict with his moral duty



## EDITORIALS

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to the public, even though that public has little opportunity either to thank or blame him. I know of no higher ethical requirement than this, and yet it is one which accountants have voluntarily imposed on themselves."

The members of our Association subscribe to this view and it is recognized as being the fundamental of the relationships between client and public accountant.

## Valuing A Chartered Accountant's Degree

By Watson Sellar

Auditor General of Canada

**I**T is with a degree of diffidence that I appear before this meeting of the Chartered Accountants' Club of Ottawa. In the first place, I was assured that no meetings were ever held on a Tuesday because that was Fibber McGee and Molly night. This is a Tuesday night! I have to tilt a lance in competition with a great American institution. Secondly, if I may make claim to a professional status—which is problematical—it would be to the Law or to that embryo profession slowly earning the name of public administration. Nevertheless, in a moment of recklessness I agreed to discuss the chartered accountant's degree. So prudence demands that a nondescript at once bespeak your tolerance. That you may safely extend because a score of your associates will, as is their habit—one by one, or, God forbid! en masse—walk into my room in the Audit Office tomorrow and put me right. Your agony will be over in half an hour; mine will not be past until tomorrow noon.

However, it is not fear of what may be my lot that prompts this statement: no profession stands on the threshold to greater things than does that of Accountancy. I am thinking not in terms of money but of professional recognition. As the Oxford dictionary says, a profession is

a vocation in which a professed knowledge of some department of learning or science is used in its application to the affairs of others or in the practice of an art founded upon it.

Those words "used in its application to the affairs of others" are significant. Anyone may tout for the work of keeping accounts or the preparation of income tax returns. That is a mere matter of contract. But when the service is in its essence public service, then we have the clothing of a profession. The medical profession, for example, is associated with the preservation of the health of the community and the legal profession with the maintenance of law and protection of civil rights. Accountancy

(An address delivered at a meeting of the Chartered Accountants' Club of Ottawa, 25th February 1947.)

more and more is being related to responsibilities to the public with respect to the financial wholesomeness of enterprise, and, in particular, of corporate enterprise. Not so long ago the Churchill Government was advised by a special committee charged with a duty to examine company statutes that the financial position of English joint stock companies should no longer be regarded as a matter of concern only to shareholders. That is to say, employees, consumers, creditors and investors had also a direct interest. In the New York Times a few weeks ago the American Economic Foundation made an appeal for the adoption of the practice of "impartial accountants" certifying all financial statements pertinent to labour-management negotiations, to the end that both sides start from a common base. The chairman of the finance committee of the United States Steel Corporation has said: "More and more the accounting for business operations is becoming public property". Those are straws which indicate the way the wind is blowing.

When shares are widely distributed, a joint stock company has elements of a national socialization—some may regard it as a compromise between pure socialism and individualism. There was a day in Canada when the death of the owner of a great fortune was dreaded by communities—too often heirs lacked either the temperament, skill or interest to administer the sources in which the capital fructified. Rugged individualism has one great blight: rarely does it perpetuate itself. Today the growth of Canada revolves to a material degree around the corporate devise, with capital supplied by thousands of investors. Nationally known names may head great corporations one year, yet twelve months later others may be in their places without confidence being disturbed. A man may die and his shares be scattered to the four winds, but the capital which those shares represent remains corporate and available for the purposes for which subscribed. Continuity is an attribute of the corporate devise, and properly employed it brings a stability to community life which individual effort cannot insure.

When I first studied the literature of your profession I must admit that I felt frustrated. Legal decisions apparently were quoted to establish alibis in event of an

error going undetected in the audit. Texts of audit certificates appeared to be loosely phrased. It seemed to me that the profession must have some role other than that of a suspicious valuator of mankind. Yet it was hard to find. Perhaps that is why the words of Mr. Justice (later Lord) Wright in the Royal Mail Packet case of 1931 opened a vista to me. You will recall that the charge was that, with intent to deceive, the chairman and the auditor of the company had published statements and accounts which they knew to be false. It was proven that, individually, each of the financial statements was true; but as the Judge pointed out:

The document as a whole may be false, not because of what it states, but because of what it does not state, because of what it implies.

In a nutshell the facts were: the company had experienced a series of operating deficits, but was simultaneously recovering large sums from the Treasury by reason of overpayments of income and business profits taxes made during the war years. These were not disclosed, but enough was incorporated into annual profit and loss accounts to provide for dividends. In short, the inference to be drawn from the financial statements was that the company was earning profits when it was not.

Mr. Justice Wright had enjoyed a large commercial practice at the Bar and passages in his address to the jury at the Old Bailey present facts which many had been loath to accept. Let me refer to two. He rejected the contention that shareholders have no cause for complaint if company finances are better than the accounts disclose. In his opinion:

there may be very great evils if those who have the control and management of the companies . . . have very large portions of the company's assets left in the secret disposition of the managing authority . . . Such a system may be used to cover up negligences, irregularities and almost breaches of faith.

A few sentences later he declared:

one cannot help wondering whether those who manage big companies do not forget sometimes that the body of directors of a company are the agents and the trustees of the shareholders, that they owe them full information, subject to proper and reasonable commercial necessity, and it is their interests that they have to study. They are not to regard shareholders as sheep, who may look up if they are not fed; they are the people whose money they are using.

You will remember that Lord Plender and other leading accountants rallied to the aid of their confrère and told the court that, had they been the auditors, they would have signed the balance sheet certificate. You will also recollect that the auditor was found not guilty. I think it is to the lasting credit of your profession that it did not sit back and claim victory. It demonstrated its vitality by re-examining practice and principles and applying correctives. But no answer was found to the question: whether the existence of a secret reserve must be disclosed. That question remained unanswered for 14 years.

In 1943 the President of the Board of Trade, Sir Hugh Dalton (now Chancellor of the Exchequer), set up a committee to study the Companies Act. It was a representative one drawn from industry, labour, finance and public administration, with Mr. Justice Cohen as chairman. One of the 13 members was an accountant. It made a unanimous report in 1945. Legislation has not yet resulted, but the present government has announced that it accepts the report and will implement it by legislation. The Committee was cold-blooded. To promote efficiency in the national well-being it selected the weapon of publicity. For example, when it considered the question whether private companies should be required to publish financial statements, the argument that such a requirement would be detrimental to the small company *vis à vis* a great competitor was rejected. Instead, the Committee subscribed to the rule of the survival of the fit:

in the public interest, stimulation or elimination of the inefficient, whether small or large, is desirable.

I appreciate that there are material differences between our company law statutes and those of the United Kingdom. But my present purpose is merely to explore trend of thought, because no one can gainsay the influence of Scottish and English accounting thought on the Canadian profession. So may I draw attention to a few of the conclusions of the Cohen Committee. It found against the practice of secret reserves. In the opinion of the Committee, objectionable consequences to shareholders were:

- (a) the balance sheet does not present a true picture of the state of affairs when assets are undervalued or liabilities overstated;

- (b) the balance of profit disclosed as available for dividends is diminished;
- (c) the market value of shares may be lower than it otherwise might be;
- (d) directors are in an invidious position in buying or selling shares when they alone know of the existence or use of reserves.

But the Committee did not stop there; it considered the problem from the public viewpoint and made the important declaration that:

disclosure would create confidence in the financial management of industry and would dissipate any suggestion that hidden profits were being accumulated by industrial concerns to the detriment of consumers and those who work for industry.

Certain exceptions are recommended: banks, discount houses and the field of insurance. The reason is that in those cases financial risks of customers outweigh those of shareholders, therefore it may be in the public interest that the true strength be under-stated in the balance sheet. In cases where special considerations merit recognition, the President of the Board of Trade may authorize departures in balance sheet treatment.

The Committee advised that the balance sheet should be regarded as an historical document which rarely purports to show the current net worth of an undertaking. It stressed that

the profit and loss account is as important as, if not more important than, the balance sheet,

because the trend of profits is the best indication of the prosperity of the company, and the value of its assets depends largely on the maintenance of the business as a going concern. Therefore, the Cohen Committee's proposal was that this account, as well as the balance sheet, be signed by the directors and certified to by the auditors. The legislation is to be specific. The account is to be in a form which will give a true and fair indication of the earnings or income of the period, and shall disclose any material respects in which it includes extraneous or non-recurrent transactions. Further, the auditor is required to draw attention if a material change is made in the basis on which the account or any item therein is calculated.

The foregoing are offered as background for the findings with respect to the audit. The Committee's view of the current situation is that:

auditors use their influence to persuade directors to present their accounts in accordance with the principles laid down by the professional bodies to which they belong, but in the absence of statutory requirements they cannot override the directors and in some cases may be deterred from pressing their views by fear of losing their position as auditors.

The Committee attacked this problem from three angles: (1) the proficiency of the auditor, (2) the character of the records, and (3) his relations with the management.

As to the first, it is desirable to trace the history. In 1926 a similar committee had rejected a proposal that only recognized professional auditors be permitted to audit corporate accounts. In 1930 another committee—one set up to consider national registration of accountants—reviewed the matter again. It reported:

Such evidence as we have on this point affords no ground for an alteration of the present law, and is, in fact, opposed to alteration.

But in 1945 the Cohen Committee unanimously found that:

An audit by an unqualified person cannot in our view as a general rule be regarded as satisfactory.

and recommended (save with respect to certain classes akin to family companies) that no person may be named auditor who is not a member of any body membership of which has been designated by the Board of Trade as qualifying its members to audit the accounts of companies or who has not been designated by the Board of Trade as qualified to audit the accounts of companies.

As to the second point, the Committee apparently disliked audit certificates which use the words "as shown by the books of the company". The proposal is that, in future, such books must be kept as are necessary to exhibit a true and fair view of the state of the company's affairs and to explain its transactions. And that the auditor must certify whether the books kept were, in fact, adequate. With respect to this, "The Accountant" has commented:

The rather serious further obligation thus thrown on auditors is obvious and we apprehend that difficulties and invidious decisions may in future be called for; but, on the other hand, the power, kept in the background, to make an adverse report, may



have its usefulness in cases where auditors are in the unfortunate position of making bricks without straw, and there is a precedent in the case of South Africa, where a similar legal provision has been found to work without difficulty.

The third provision is to secure the auditor's independence from dictates of management. Should he be expelled from his society, he automatically ceases to be eligible to act as auditor. That is obvious, but a more interesting provision relates to the situation when the management decides to replace him by another—presumably because he is unwilling to do what it wishes. He is to enjoy a right of circulating his written views to all shareholders, at the expense of the company, and to appear and speak at all general meetings—whether or not financial matters are items on the agenda.

You will thus observe that the intent is to establish efficiency and independence in the audit. The status of the auditor is to be that of a professional retained, not employed, to perform a professional service. I submit that, in its true perspective, the aim is that the auditor be a "public" not a "private" examiner. It is not a contract of service, but the performance of a professional duty to the public.

For present purposes it is immaterial whether our company legislation is better or worse than that of England. My contention is that a profession knows no geographic frontiers. I have said that the Canadian branch faces a pleasing vista. Are you equipped to grasp your opportunities? In 1854 when Queen Victoria granted the royal charter to the Edinburgh accountants, it was because, in her opinion, the accountant required great experience in business, very considerable knowledge of the law and other qualifications which can only be attained by a liberal education.

A man would be a fool were he to argue that the Canadian profession, either collectively or individually, has no great experience in business. No profession made a finer contribution to the war effort than did that of Canadian accountancy. Repeatedly was I told by British and American representatives that nowhere were war accounts as well maintained. The obligation placed on your profession to provide the Department of Munitions and Supply with special certificates as to profits of war contractors

and the information which auditors had to supply to the Department of National Revenue on the T.2 questionnaire form are a clear indication of the place you hold in our national life. As to your legal attributes, listen to the complaint of lawyers that you are stealing business from them, or read the brief of your Association to the Senate Committee on income tax and we have an answer as to whether you have a "considerable knowledge of the law". I am less satisfied that you demand of your students "qualifications which can only be attained by a liberal education". If an outsider may venture a suggestion, it would be that more thought be given to that. The true professional is more than a technician. His strength lies in his independence and in his ability to apply his brain and skill to a problem; and we all know that the broader the vision and the more diversified the talents, the greater is the contribution to a solution. I would like to think of your profession as one composed of personalities—of a body whose members may say, when accepting an audit proposal, as did the barons of centuries ago to their King:

We, who are each as good as you, and who are together more powerful than you, promise obedience . . . if you maintain our rights and liberties, but not otherwise.

## The Income Tax Appeal Board And Its Place In The Profession Of Accountancy

By H. H. Stikeman, B.A., B.C.L.

**I**T HAS been said that the average taxpayer is no more capable of a grand passion than of a grand opera. When Israel Zangwill wrote this in 1926 he evidently had not had an opportunity of seeing some of our clients on a bright April morning in the throes of a T. 1 General. Nor could he have contemplated the intensity of public feeling engendered during the last session of Parliament in Canada when the 1946 Budget was brought down.

Passionate is, I think, the most apt description of almost any Canadian taxpayer today. This statement is becoming truer now that Spring is almost here and the wind and newspapers are once more laden with the hum of Ottawa's legislation mill. We must, therefore, turn our attention to what the future may hold in this wonderful field of practice where all things are impossible.

As last year, so this year also the two main objects of interest will be first, the possibility of reduced rates, and second, those still uncompleted monuments to the blind goddess, the Board of Tax Appeals and the Income Tax Advisory Board. As I find it extremely difficult to believe in the first tonight, I will content myself with giving some thought to the second.

When I speak to you of these Boards, I do so with a particular sense of a new comradeship between us. Looking around this room I see before me a large number of ladies and gentlemen who have suddenly become potential advocates at the Revenue Bar.

As you know, subsection (7) of the Third Schedule to the Income War Tax Act setting up the Income Tax Appeal Board expressly states that an appellant may appear in person or be represented at the hearing by counsel or an agent. The word "agent" is, I think, wide enough to include those before me. Accordingly, I foresee the chartered accountant being cast upon the uncertain seas of advocacy just as his cousin the advocate has been stranded upon the shifting sands of accountancy. In the words of Tennyson,

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An address given to the Chartered Accountants' Students' Society of Quebec, on February 11, 1947.

"You will now have to master the lawless science of the law, that codeless myriad of precedent, that wilderness of single instances" and endeavour to keep yourself from losing any remaining vestiges of sanity which have been preserved to you so far in your dealings with lawyers heretofore. This raises a very important subject to which I will come in a moment after I have outlined the background of the Boards and some of their functions.

### **The Need For The New Boards**

As I said some time ago to your cousins, or perhaps your nephews, the cost accountants, I think the most important single feature of the 1946 Budget and certainly the most revolutionary piece of tax legislation which has been introduced in Canada in recent years, was the provision for the establishment of the Income Tax Appeal Board and the Income Tax Advisory Board. As most of you are familiar with the reports of the Tax Committee of your Association I will not spend too long outlining the steps which lead to this event.

During the twenty-eight year administration of the Income Tax Statutes by the Department of National Revenue, the stakes for which the taxpayer and the Crown have been playing rose very sharply, more particularly, in recent years. As the stakes increased, the Crown, being only human, found it increasingly difficult to satisfy the demands of justice with its right hand while reaching for the money with its left. For many years the taxpayer's only recourse was to the Exchequer Court. After a number of Parliaments had practised their draftsmanship upon the taxing statutes, however, even the Exchequer Court reached the point where it had great difficulty in rationalizing good business and accounting practice with the requirements of the taxing law. Thus, there grew up a body of tax law in legislative and judicial form which diverged more and more widely and at an increasing rate from the natural and inevitable requirements of sound business and accounting. At the same time, Parliament was persuaded to grant to the Minister of National Revenue a number of what Hollywood might term "magic" powers by means of which the Minister could perform "the Ottawa rope trick" and lift himself out of the reach of his pursuers in a great number of cases by the use of his ministerial discretion.

These discretionary powers have been the subject of some considerable litigation in the Exchequer Court. With the exception of the Privy Council decisions in the cases of *Wrights' Canadian Ropes Ltd. v. Minister of National Revenue* (1947), *Canada Tax Cases 1*, and *Pioneer Laundry and Dry Cleaners Ltd., v. Minister of National Revenue*, (1938-39), *Canada Tax Cases 411*, I can recall no others turning upon the exercise of ministerial discretion which were lost by the Crown. I think perhaps it is more accurate to say that the *Wrights' Ropes* case is the only case which has been lost by the Crown in this connection.

With regard to the decision in the case of the *Pioneer Laundry and Dry Cleaners Limited* it is true to say in a technical sense that the Minister lost the case when it is regarded purely and simply as a lawsuit. It is also true, however, that the taxpayer lost the case when it is viewed in the light of any benefits conferred upon him.

The *Pioneer Laundry* case, to digress for a moment, was a case where an already existing company, *Pioneer Laundry and Dry Cleaners Limited*, sold assets which it had fully depreciated to a new company incorporated to purchase those assets at an appreciated value. Both companies were held by substantially the same shareholders. The Minister of National Revenue refused to permit the new company to charge depreciation on the new value of the assets, ruling that they had been fully depreciated in the hands of the vendor and could not be depreciated over again in the hands of the purchaser. The reason given by the Minister was that the two companies were to all intents the same taxpayer because the shareholders of each were the same persons. In view of the longstanding decision of the House of Lords in *Salomon v. Salomon*, (1897), A.C. 22, that a corporate entity is separate and distinct from its shareholders, the Privy Council stated that the Minister had erred in law in basing the exercise of his discretion upon such grounds. Accordingly, the matter was referred back to the Minister who thereupon permitted the *Pioneer Laundry and Dry Cleaners Limited* to depreciate the new assets in question at one dollar. Thus, while the Minister lost the case, the Court had no power to substitute its opinion for his ruling, and merely referred the matter back to him for a re-exercise of discretion on proper grounds. This principle has been repeated again and again

by various judges of the Exchequer Court. The latest and most important instance of the enunciation of this principle is found in the decision of Mr. Justice Thorson, President of the Exchequer Court, in the case of *Pure Springs Limited v. the Minister of National Revenue*, (1946), *Canada Tax Cases*.

The Wrights' Ropes decision turned upon the Minister's disallowance of a royalty or fee which a Canadian subsidiary, Wrights' Ropes Limited, of a British parent company, was obligated to pay to that parent company under a contract which had existed since 1935. The Canadian subsidiary had entered into a contract to obtain exclusive access to British Columbian markets in the sales of wire ropes. Under the terms of the Agreement it was required to pay to its parent 5% of net profits before taxes each year. During the war years, as was to be expected, the net profits of the subsidiary increased dramatically as did the dollar value of the 5% commission. The Minister of National Revenue accordingly disallowed the commission with the exception of an amount of \$7,500 per annum under the provisions of section 6(2) of the Income War Tax Act. As you will recall, section 6(2) reads as follows:

6. (2) The Minister may disallow any expense which he in his discretion may determine to be in excess of what is reasonable or normal for the business carried on by the taxpayer, or which was incurred in respect of any transaction or operation which in his opinion has unduly or artificially reduced the income.

In the Exchequer Court of Canada it was argued for the Crown that the Minister's discretion is not subject to review by a Court and that in fact there is no appeal provided in the Statute from the exercise of that discretion itself. It was argued further that the appeal provisions which existed in the Statute were provisions regarding appeals from assessments only and that the exercise of discretion was not a matter which was part of an assessment but an administrative act long preceding the assessment.

The learned President concurred in this view and upheld the Minister's decision. The taxpayer then took the matter to the Supreme Court of Canada where the counsel for the appellant raised the point that section 63 requires all the documents relative to the assessment to be produced in Court and contended that one of the documents which

was relative to the assessment, a secret report from the office of the District Inspector at Vancouver, had not been lodged in Court and moreover had not been made known to his clients and that accordingly the rules regarding the exercise of ministerial discretion had been violated, the Minister had acted fancifully and arbitrarily and the matter must fall. The Supreme Court, however, with due regard for the dangers of expressing itself too definitely, held that section 63 did require the filing of all documents in the Court. The Supreme Court held that section 63 had not been properly observed and that accordingly the case must be sent back to the Minister. It was not stated that the discretion had been properly or improperly exercised but merely that a formal lack in the trial proceedings had been uncovered which violated the matter.

The Crown then appealed and went before the Judicial Committee of the Privy Council. The learned Law Lords founded their judgment upon a very fundamental question. In effect they stated that the Courts have long established certain rules by which a Minister must act in exercising discretion. For example, he must act honestly, he must give the taxpayer every opportunity to be heard, he must not act arbitrarily and fancifully and he must not take into consideration factors which are improper in the circumstances. If the Minister observes these rules no Court can substitute its opinion or its standards of reasonable action for his.

The Court did not dispute the application of these principles nor did it hold that if the principles were violated the Court could substitute its opinion for the Minister's. It did, however, consider the very practical question as to what facts a Court is entitled to have before it to judge of the sufficiency of the reasons upon which the Minister acts in order to determine whether or not he has observed these rules. The Privy Council noted that the Minister had not condescended to display the confidential report upon which he stated that he relied, among other documents, on the exercise of his discretion. They said that they could not, after a review of the other factors before the Minister, reach the opinion that there were sufficient facts before the Minister to permit him to come to a decision which was not arbitrary and perhaps even fanciful.



Accordingly, it was held that the taxpayer must succeed. At this stage, unlike the judgment of the Privy Council in the Pioneer Laundry and Dry Cleaners case, the Court did not refer the matter back to the Minister but vacated the rule of the Supreme Court that the Minister should have another chance to exercise his discretion properly and held that the taxpayer's assessments must be amended in his favour and finalized in that way.

Thus, the Crown lost not only the case but also the opportunity of undoing its result by further administrative action properly executed.

Informed public opinion and legislative feeling reached a peak of frustration and determination last year with the appointment of a Special Committee of the Senate to examine into the provisions and workings of the Income War Tax Act. This Committee prepared a report after the hearing of some twenty-three witnesses and an examination of the tax systems in other jurisdictions. The report recommended separation of the authority which imposed the tax from that which decided appeals. It was, therefore, suggested that a Board of Tax Appeals should be set up with jurisdiction to review not only questions of law arising out of assessments on income tax, excess profits tax and succession duties, but also with authority to consider problems arising out of the exercise of ministerial or administrative discretion with the power to substitute its opinions for the Minister's and to replace his administrative and discretionary decisions with one of its own.

This report was duly conveyed to the government and in his Budget Speech Mr. Ilsley gave the Committee perhaps more credit than was its due for the Boards which he then set up. He referred to the work of the Senate Committee which he appropriately mentioned as "a Special Committee set up in another place", and stated that the main suggestion was for the setting up of a Board of Tax Appeals and that "it is proposed to accept this suggestion with certain modifications".

Legislation was passed authorizing the establishment of the two Boards I have mentioned, but with substantial changes from that suggested by the Senate Committee. Where that Committee had recommended one Court with full power over ministerial discretion, as well as over assessment disputes, and with the authority to substitute its

opinion for the Minister's, the legislation authorizes two Boards, one with the limited powers of a Court of first instance over appeals from assessments of income tax only and the second with even more limited powers of an advisory quality to assist the Minister of National Revenue in dealing with discretionary matters. The latter Board would not be able to make binding decisions in its advice to the Minister, much less vary decisions already made or substitute its opinion for his. In neither case would the Board have jurisdiction with respect to questions arising out of assessments prior to the 1946 taxation year.

#### **The Nature of The Remedy**

By Part 8A of the Third, Fourth and Fifth Schedules of the Income War Tax Act, all of which were enacted in 1946, the old provisions for direct appeal to the Minister and then to the Exchequer Court in respect of 1946 and future income tax assessments have been abolished and the two new bodies I have referred to have been interposed between the Minister and the Exchequer Court. These two bodies are known as the Income Tax Appeal Board and the Income Tax Advisory Board. With respect to appeals from excess profits tax or succession duty matters, however, the old approach to the Exchequer Court remains unaltered.

The Income Tax Appeal Board will be a court of record for the purpose of hearing questions of law arising out of assessments made by the Minister of National Revenue under the Income War Tax Act alone. It will have no jurisdiction to consider questions arising on assessments under the Excess Profits Tax Act or the Dominion Succession Duty Act. Nor will it have jurisdiction to review questions of ministerial discretion.

The Income Tax Advisory Board, on the other hand, is not to be a court of record nor a body which can bind the Minister or alter his decisions. It is, as its name suggests, an advisory committee to assist the Minister and to advise him in the exercise of his ministerial discretion in respect of certain limited and specified sections of the law. For example, the Advisory Board can advise the Minister with respect to the exercise of his discretion in connection with changes of fiscal period, the blending of interest and principal payments, *per diem* and travelling allowances, foreign corporation dividends, co-operatives, living expenses, cer-

tain classes of exemptions and deductions, abnormal expenses, tax credits of certain kinds, residence for purposes of the non-resident withholding tax and a number of other administrative sections only.

The Income Tax Appeal Board is to be appointed by the Governor in Council and to consist of a chairman, two assistant chairmen and not less than three, or more than nine, other members. The chairman and assistant chairmen must be either a Judge of a Superior Court of Canada, or a barrister or advocate of at least ten years' standing at one of the Provincial Bars. No individual can be appointed to this Board who is sixty-five years of age or over. When appointed the office will be held for ten years, but it is presumed that he may be reappointed.

Other provisions of the Third Schedule indicate that the Board may either travel or have resident members throughout the country who may appoint individuals to act with them for temporary hearing purposes.

It is provided that the Income Tax Advisory Board shall consist of a chairman and not less than two or more than six other members. There is no professional limitation upon the qualifications of the chairman or the other members. However, they too must be less than sixty-five years of age, after which age they cannot remain a member. As in the case of the Income Tax Appeal Board, however, every member holds office for a period of ten years, but may be removed for cause at any time by the Governor-in-Council. They may, however, be reappointed at the expiry of the ten-year term if they are not disqualified by age.

#### **Some Considerations Regarding Your New Field of Practice**

As I started to say at the beginning of this talk, some of you may become tax advocates and practise before these Boards. In this event, you will have to do a certain amount of re-orientation in your professional thinking. In order to properly achieve this change of position, there are certain elements which I feel I might point out to your advantage.

As auditors and chartered accountants, you are primarily concerned with the accuracy of financial statements and the morality of your clients in that connection. You are

guardians of the public to almost the same extent that you are champions of your client's interest.

In your new capacity as potential advocates before the Revenue Bar, you will have to take note of a distinction which is so well-known to judges and lawyers as to be rarely found in writing, namely, that law and justice may be two different things. Justice in the sense of ethics has a place in law only as a foundation from which spring the main principles by which social life is guided. Emmanuel Kant has said that no law has any ethical quality in itself when viewed apart from the will of the actor. The law maintains this objective outlook with respect to morals but it has not entirely divorced itself from them.

Gellenek, as quoted by Korkunov in his book "General Theory of Law" at page 61, states that "the law is a minimum ethics, that is to say, the whole combined requirements of morals whose observance at a given stage of social development is absolutely indispensable". Thus, law is a distillation of the minimum requirements of morality and the construction from them of a rule of principle which is not to be measured by any moral critique.

The law is a constantly changing and shifting whole. When it ceases to change it becomes moribund because its rules have only validity in so far as they have the daily push and pull of human interest to activate them. As Dean Whitehead remarked in his book "Science of the Modern World", at page 24: "If science is not to degenerate into a medley of *ad hoc* hypotheses it must become philosophical . . .". So with the law. A rule of ethics may be an absolute norm and not require substantial re-examination from generation to generation. The law, however, while it is a body of principle, is a pragmatic thing and must be re-examined periodically to ensure that it keeps pace with the needs of society and the business world and does not hinder them by falling behind.

You will find, therefore, a strange conflict between justice as the moralists expound it and the rule of law. You will find that while the law purports to be founded upon a solid mass of principle yet it changes and fluctuates to meet changing conditions and that it veers now close to and now far from the straight line of ethical continuity which has remained relatively unchanged from the Hellenic age.

As auditors however you will not be concerned with the variations in the law save as to satisfy your own mind of the consistency of any general proposition. What you will be most concerned with, however, is first, to distinguish between the rule of ethics and the rule of law, and second, to become at all times the champions of the rule of law against what Lord Hewart has termed "administrative lawlessness". In his book "The New Despotism", Hewart, who was then Lord Chief Justice of England, and in a position to fully appreciate the gravity of the situation, made the following statement:

What is meant by the rule of law is the supremacy or the predominance of law, as distinguished from mere arbitrariness or from some alternative mode, which is not law, of determining or disposing of the rights of individuals.

The rule of law is essentially that which is determined and applied by a Court. It cannot be determined and applied by an individual in the exercise of unfettered discretion. It is this discretionary power against which Lord Hewart inveighs when he uses the expression "administrative lawlessness". It is this "administrative lawlessness" which Parliament has recognized by the establishment of the two Boards we are now discussing.

There is another consideration which we must both bear in mind. It is up to your profession and to my profession to see that the taxpayer has every advantage to which he is entitled under the law and upon the facts of his case. It is, however, also up to our two professions to see that the Boards are not overburdened with frivolous appeals and to set a standard of performance before them that will assist in the building up of a body of precedent, the existence of which will discourage the less discerning from launching frivolous actions. It must always be remembered that an appeal lost is not just the client's case lost; it is a new precedent in the body of law against the taxpayer.

In determining the value of an appeal beforehand, great care must be taken not to mistake the intention of the legislator for the law instead of the language of the statute. A statute cannot be over-extended or circumscribed to mean more or less than its own language permits. There can be no question of reading into a statute the intention which it may be thought that the legislator had in framing it, even though its words may not be clear. There are two state-

ments which are worthy of remembering in this connection for their humour as well as for their wisdom—Sir Rowland Burroughs in his book "The Interpretation of Documents" says: "It may happen that the writer has obviously set out with the intention of declaring one thing and has succeeded in saying quite plainly some other thing. If that is the case, then effect must be given to his words. It would not be the first time that a Balaam has set forth with his ass to make a solemn declaration and has found on the way that his intention has been defeated by the words of his ass." On the other hand, Lord Simon has declared that "we must not give the statutory words a wider meaning, because on an unformulated construction the words might leave a loophole for frauds on the revenue. If, on the proper construction of the section that is the result, it is not for judges to attempt to cure it."

As in all income tax matters, the facts of each case are of the greatest importance and they will be of particular moment before the Income Tax Appeal Board. The facts determine the application of the law in every case. As auditors, you will, in most tax cases, be the masters of the facts. In this you will, I think, have your services utilized by most lawyers who go before this Board.

In the preparation of a case for a hearing, which, I presume, will follow the accepted sequence of a normal civil trial, the drafting of pleadings and the accurate evaluation of facts is of great importance. Once the facts are clearly and fully established, the law may be argued with confidence. It has been frequently stated that all law suits are 80% won before they are argued, and I cannot emphasize the importance of your part in the picture more strongly than this.

The preparation of pleadings in these matters will, however, be quite unlike the preparation of Briefs, in which your profession excels, to the Board of Referees. Those Briefs, in the main, rely upon the facts of each case with only a brief reference to the statutory requirements. In pleadings before the Appeal Board, however, every fact put in or left out will have its place in the final legal argument as a basis for a point of law or the avoidance of a legal pitfall.

Stated very simply, the procedure in a law suit is, as you no doubt know, for pleadings to be filed in advance of

trial setting forth the facts upon which counsel will rely. The appellant endeavours to found his case by proving the facts which he has asserted in his pleadings, and passes on to base his arguments of law upon the evidence he has so adduced. The respondent then replies with his argument in law, basing it upon either the facts which the appellant has presented or upon the facts which he himself has been able to prove by means of other evidence or cross-examination. After the respondent has replied in law, the appellant has a final opportunity to answer him in law without deviating from the facts. If any facts have been misstated or left unproven, they cannot be relied upon or referred to in the legal argument, and cases are often lost by facts being inadvertently omitted or not being sufficiently proven to the satisfaction of the Court.

It has been my experience, both in the Department and in private practice, primarily in the capacity of a tax counsel, that in the taxation field the services of an auditor and lawyer are almost equally indispensable to the client. Unfortunately, in the past, business men as well as lawyers and accountants themselves have failed to grasp this fact to the full and many mistakes have been occasioned by reason of one or the other failing to take the advice of his counterpart in the other profession.

The practice before the Income Tax Appeal Board will, I think, become an outstanding example to the business community, not only for the need for lawyers and accountants to work together on major tax problems, but also of the facility with which they can collaborate and the benefits which such collaboration will bring forth in the fruits of victory. Your opportunity to appear before this Board is really an opportunity for our two professions to act in concert and to set an example, not only to the business community, but to other professional groups, of efficiency and harmony, which will inevitably rebound to the advantage of our clients and ourselves in many ways.

I think I can speak for the whole of my profession when I say to you tonight: "Welcome to the Revenue Bar—Welcome and good hunting!"

In so welcoming you, I am conscious that perhaps at last there has been stilled the echo of that cry of St. Luke:

Woe unto you lawyers, for ye have taken away the key of knowledge; ye entered not in yourselves and they that were entering in ye hindered!



## International Financial Policy

**I** WISH to speak to you tonight on international financial policy with particular reference to the two institutions set up by the Bretton Woods Agreements—the International Monetary Fund and the International Bank for Reconstruction and Development.

My reason for choosing this subject is two-fold. First, because both the International Monetary Fund and the International Bank for Reconstruction and Development have recently commenced active operations and second, because I believe that there is a good deal of misunderstanding in the minds of many people as to what these institutions are and how they fit into the general scheme of things in the field of international financial policy.

Most Canadians know something about our domestic financial policy during the war and in the transition period since the end of the war. We have all become familiar with our stabilization policy and program. We all know something about controls and what they do in keeping down the cost of living and ensuring a fair distribution of scarce supplies. I do not believe however that many Canadians realize what an important job Canada has been doing in international financial matters both during the war and since the end of the war.

That Canada should take a leading part in international financial affairs is quite understandable. Economic isolation for Canada as for all countries in the modern world is as impractical a policy as political isolation.

We have been doing a great deal since the end of the war and indeed during the latter years of the war to help those nations, which have been and must be our customers, buy from Canada during the post-war period. Export trade is the basis of Canada's employment and prosperity. Something like one-third of our people are directly dependent upon it, while the rest of us depend upon it indirectly to a considerable degree. Without good export markets and healthy export industries, Canada cannot be prosperous.

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An address by the Honourable Douglas Abbott, Minister of Finance, to the Institute of Chartered Accountants of Quebec, Thursday, March 27th, 1947.

Our export markets are spread all over the world. A large part of them, however, lie in Britain, in countries in the sterling area that are largely dependent on Britain for foreign exchange and in European countries which have suffered so greatly both physically and financially as a result of the war. It became obvious during the latter years of the war that these countries would find it difficult to buy from us what we wanted to sell them immediately the war was over because their own export trades had been so seriously interrupted by the war and because their essential import requirements were so greatly swollen by post-war needs that they would be acutely short of foreign exchange. It looked, therefore, as though it might be many years before trade could be established on a normal pattern, unless special measures were taken to meet problems of the transition period.

Even before the war, many of our customers in Europe had not been able to buy from us on a satisfactory scale due, in considerable part, to the shortcomings of foreign exchange and financial arrangements. Many of our competitors had sought by special devices in the field of foreign exchange to gain an unfair advantage over us. Exchange rates in the 1930's had been unstable and this had made international trade more difficult. Countries had competed against one another in depreciating their exchange rates in an effort to gain advantages in exporting. International lending was being carried on at such a low level that those countries in need of long term loans to develop their own production and trade were unable to get them.

Canada and other allied nations were determined that international financial arrangements after the war should be more sensible and workable and that they should encourage economic expansion rather than economic restrictions. If possible, this should be done by means of the cooperative international action that had been so successful in the winning of the war itself. As a consequence, officials of Britain, United States, Canada and several other countries had a number of informal discussions during the war years which finally led up to the calling of a conference at Bretton Woods in the summer of 1944 attended by representatives of forty-four of the United Nations. This conference drew up the articles of agreement of the Inter-

national Monetary Fund and the International Bank for Reconstruction and Development.

The International Monetary Fund is an association to deal with foreign exchange questions. The purpose of the Fund is the promotion of exchange stability and orderly exchange arrangements among nations. To accomplish this purpose it lays down certain standards of behaviour which the members agree to observe and helps the members over rough spots in their international transactions by making foreign exchange available to them in specified amounts on an assured basis. The main objective of the Bank is to make loans to aid in the reconstruction of war-devastated countries and the development of economically backward areas.

Of the forty-four nations which attended Bretton Woods, forty-one have become charter members of the two institutions. The three countries participating in the discussions at Bretton Woods which have not joined to date are U.S.S.R., Australia and New Zealand. During the last few days word has been received that the Australian House of Representatives has authorized Australia to join the Fund and the Bank. In addition to the original members, applications for membership have been received from Italy, Turkey, Syria and Lebanon and have been approved by the Boards of Governors. The capitalization of the institutions is approximately \$7,500 million each.

As I have indicated, the Fund is concerned in large part with establishing a code of behaviour in the field of international financial relations. It represents an attempt to avoid currency evils, such as competitive exchange depreciations, blocked accounts, clearing agreements and so on. We in Canada fortunately have had very little to do with most of these difficulties, except that our exporters have encountered them in selling in foreign markets. Because these practices restrict and divert trade, they would interfere with our exports and imports, and would constitute a serious threat to our full employment policy if we did not guard against them.

I do not propose to spend a great deal of time in outlining the specific provisions of the Fund Agreement. I will recall merely that each country agrees with the Fund on the initial par value of its currency and agrees not to change this except after consultation with the Fund. This

provision is designed to assure that there will be no changes in exchange rates resulting from temporary conditions which do not reflect a basic need for such change. If a member wishes to make a change not exceeding ten percent, the Fund has no right to object, but the member must consult the Fund and only propose a change if it is needed to correct a fundamental disequilibrium. If the proposed change exceeds ten percent the Fund has the right to object.

The second main obligation which members of the Fund assume is they agree that they will not seek, through currency methods, to bring about a bilateral balancing of accounts with each of their trade partners but will pay for current transactions in currency that may be exchanged for other currencies needed for trade. In this way all countries belonging to the Fund will be able to use the proceeds of their exports to each member of the Fund to pay for their imports from any other member.

This obligation, known technically as the "convertibility of currencies" or even more technically as the "multilateral convertibility of currencies", is of special significance to Canada, for, as you are well aware, our trade is not neatly balanced with each of our trade partners. In fact we import much more from the United States than we export there, while we export much more to the United Kingdom and Europe than we import from there. While these triangular tendencies in our trade relationships were in existence for many years before the war, they have been intensified during the present reconstruction period. This has been as a result of our supplying large amounts of goods to the United Kingdom and Western Europe to aid in the economic reconstruction of our good customers in that part of the world and our imports from the United States being unusually heavy on account of the high level of economic activity in Canada, the extensive re-equipment of our industry and the sudden flow of goods available from United States now that reconversion in that country has been accomplished.

When the International Monetary Fund arrangements come fully into effect there will be a ready mechanism available by which we can use the proceeds of our exports to the United Kingdom and Europe to provide the means for paying for our imports from the United States. I should point out however that the Fund agreement specifically

permits the postponement of this obligation of convertibility of currencies for a limited transition period. Most member countries, including Canada, will not therefore assume the full obligations of convertibility immediately.

The obligations I have mentioned regarding exchange stability are important and, to assist member countries in carrying them out, the Fund provides financial resources to be made available to members to meet deficits in current international transactions.

Each country on joining the Fund subscribes an agreed assigned quota—the United States subscription is \$2,750 million, the British \$1,300 million, Canada's (which is the sixth largest) is \$300 million. Of these subscriptions, twenty-five percent is paid in gold provided however that no country need pay more in gold than ten percent of its gold and U.S. dollar reserves. The rest of each country's quota is paid in its own currency. These subscriptions provide a pool of foreign exchange. Members are entitled to buy foreign exchange from the Fund to meet current payments abroad, roughly up to an amount equal to their quota plus their gold subscription, at the rate of twenty-five percent of their quota per year. The Fund therefore constitutes supplementary exchange reserves, which members can draw on in case of need.

The Fund opened its doors for exchange business on March 1st. Before doing so it reached agreement with practically all its members on their initial par values, and these par values were announced by the Fund a couple of months ago. In the case of Canada the initial par value is parity with the American dollar. The other par values agreed upon were those already in effect.

It will be clear from what I have said that the Fund is primarily intended to operate in and deal with the problems of, what, for want of a better word, we may call normal times. It is not intended to provide the huge sums of foreign exchange needed by countries which were devastated by the war or whose trade was so depressed or distorted by the war that they need large sums to bridge the gap until they are back on their economic feet. It is not intended that the resources of the Fund needed for its normal operations in future years should be tied up in meeting reconstruction needs, for otherwise the real purposes of the Fund would be frustrated. Consequently, a

special provision has had to be made in the Fund Agreement for this transition period and the Fund must be expected to operate somewhat differently to what it will several years hence.

It was still necessary however to make special provision for the abnormal reconstruction requirements of the transition period. To a large degree this has been done by direct loans from one Government to another, to which I shall refer in a moment. When the Fund was established, however, provision for meeting these abnormal reconstruction requirements was also made by creating, as a sister institution to the Fund, the International Bank for Reconstruction and Development.

The International Bank is easier to understand than the Fund. It is essentially an organization to make loans to member countries to provide them with foreign exchange for their reconstruction programs or for projects of economic development. It can also help member countries to borrow for these purposes from private lenders by guaranteeing the loan.

The Bank will get its money to make loans from two sources. The first and smaller source will be the capital subscribed and paid in by all the member countries. The second and main source of money to the Bank will be funds borrowed by the Bank itself directly from private investors by the sale of the Bank's bonds or debentures.

To give the Bank the necessary credit standing to enable it to borrow in this way, each member government agrees to pay up, if required, four times the amount of capital initially paid up, if that should be needed to enable the Bank to meet its own obligations in case there should be defaults on the loans it makes.

At this point I might refer briefly to the way the Fund and Bank are organized. The original and ultimate authority in each case is vested in the Board of Governors, one representing each country, corresponding roughly to the shareholders of an ordinary company, and having votes roughly in proportion to their quotas or capital subscriptions. There is no veto. The governors are normally the Ministers of Finance of the member countries, and as such I am Governor for Canada of both institutions. Provision is made for alternate Governors as well, and in the case of Canada, Mr. Graham Towers is my alternate. The Board

of Governors of course, does not meet frequently—normally only once a year for a few days. The main control over the policy and activities of the Fund and the Bank is exercised on behalf of the Governors by the Board of Executive Directors in each case, consisting of twelve Directors, with alternates if they desire to have them. These correspond roughly to the Board of Directors of an ordinary company—or perhaps somewhere between that and the Executive Committee of an ordinary Board of Directors.

In most cases the Executive Directors devote their full time to this work and are paid salaries by the Fund or Bank, but we Canadians did not favour this arrangement, and consequently our Directors have been representatives going from Ottawa from time to time as required, while the Financial Counsellor at our Embassy in Washington is continuously available there as an Alternate.

Mr. Rasminsky, the operating head of our Foreign Exchange Control Board, is Executive Director for Canada of the Fund, and Mr. Bryce, of my Department, who deals with our foreign lending program, served until recently as our Director on the Bank. A few weeks ago Mr. Graham Towers himself agreed to serve for a time as Executive Director of the Bank at this critical period in its operations, and this has been arranged. I am confident that his experience and judgment in financial affairs will be of great value to the Bank.

During the immediate post-war and peace-making period, much more in the way of international financial assistance has been required than could be furnished by the Bretton Woods Institutions. Britain and other countries whose international financial position has been so weakened as a result of the character and extent of their contribution to victory have required large scale loans.

The United States has extended loans or credits amounting in all to approximately 9 billion dollars, while we in Canada have provided credits of approximately \$1,850 million, including, of course, our credit to Britain. Britain herself, although the largest borrower and now the greatest debtor in the world, has made substantial loans to France and to Denmark. The loans provided by the United States and ourselves on such a large scale have been made with our own interests in mind, although they have been of great help to the borrowing countries. Without such



loans, Britain, France, Belgium, Holland and Norway, the largest borrowers, would have been unable to re-establish their economic life at anything like the speed that has been possible.

We realized that if those countries were not able to obtain financial help during the transition period, they would not be able to undertake the obligations required for participation in a world trading system and that the future of world trade would be threatened. This was particularly important to us in Canada. We are not only dependent on a large volume of trade, both export and import, but we are particularly dependent upon being able to sell in British and European markets and use what we receive from them for buying in American and other markets. This multilateral trade, as we call it, is therefore of vital interest to Canada.

Without assistance Britain and our other customers would be forced to adopt trade practices which would destroy the world trading system on which Canada's prosperity and standard of living depend. It was only using common sense on our part and exercising self interest to try to hold these export markets by doing what we could to help our customers through their temporary difficulties. Prompted by these reasons, we in Canada have extended credits to France, Holland, Belgium, Norway and Czechoslovakia and, of course, the special loan to Britain which was approved by Parliament last year.

There are, of course, difficulties and risks involved in the effort which Canada has made to help in rebuilding a world economic system. We have met these difficulties and assumed these risks with our eyes open, because, in our considered judgment, the difficulties and risks of any alternative course of action would have been even greater.

Our stake in world recovery is so great that we are obliged in our own interest to back the reconstruction of our traditional customers and friends to the limit of our resources. These countries need a breathing space in which to restore their productive equipment from the ravages of war before they are able to make both ends meet on international account. If the breathing space is inadequate and they run out of foreign credits before they have re-established their economics, they will be forced into defensive measures of economic policy. We should

then witness a revival of all the destructive action of the 1930's—restrictionism, discrimination, excessive protection. Surely we in Canada have suffered so much from this type of economic policy in the past that it is the plainest common sense for us to leave no stone unturned in the effort to prevent its revival.

The International Bank, which was created for that purpose, is now taking over the task of financing reconstruction requirements—at least the bulk of them. Already needs have been met to a very large extent. The reconstruction loans for which applications have been made to the Bank are far less than the loans which the United States and Canada have granted, and it seems unlikely that the Bank will be called upon to make loans for reconstruction on a scale even half that which individual lending countries have already provided. Already a considerable measure of recovery has taken place in Britain and on the Continent of Europe.

On the other hand, there have been set-backs. The terrible weather in Europe and in Britain this year has added greatly to their difficulties and needs. The shortage of coal throughout the world has held back the pace of industrial recovery and retarded the development of exports by borrowing countries. The shortage of wheat and other cereals has forced prices up to high levels and increased considerably the difficulties of the borrowing countries. The situation has not been helped by the rise in prices which has taken place, particularly in the United States since the American credits were extended to the United Kingdom and other countries, as this rise in prices has considerably reduced the commodity value of the loan. Our own economy has felt and is still feeling the unfavourable impact of high and rising prices in the United States.

One aspect of the present situation of particular significance is that we are exporting large amounts of goods to the United Kingdom and Western Europe on credit while our imports from the United States, which are running at high levels, are being paid for in cash. This is obviously not a situation which can continue indefinitely but it is not one which has developed unexpectedly—it has been foreseen for some time that this development would take place.

My predecessor, Mr. Ilsley, in introducing the Foreign Exchange Control Bill in the House of Commons last June,

after referring to Canada's contributions to the solution of international financial problems through participating in Bretton Woods and extending large credits to the United Kingdom and other countries, said:

"This does not mean, however, that we can afford to throw all caution to the winds and act as though the world's economic problems had been solved. For some time to come the international financial position of many countries will continue to be abnormal and we shall have to count on providing a large portion of our exports to certain of those countries on credit terms. These exports will not produce equivalent amounts of foreign exchange which we shall be able to use to pay for our imports from the United States".

Fortunately we ended the war with substantial reserves of gold and U.S. dollars which have enabled us to obtain and pay for a high level of imports while exporting on credit goods which are necessary for re-establishing the economies of the United Kingdom and Europe. It was in part in anticipation of this situation that power was sought, and obtained, to continue control of foreign exchange transactions and particularly to ensure that our U.S. dollar resources are not used for undesirable exports of capital.

In concluding this survey of international financial relations, may I say that in my opinion the next year or two are likely to be of crucial importance. National recovery from the effects of war is well advanced in most countries. Important institutions of international collaboration have been established in the form of the Fund and the Bank. They are endowed with large financial resources which provide not only sources of financial assistance but also a forum where countries can calmly discuss their problems with each other before they reach a critical stage. Large credits have been made available by the United States and Canada to aid in reconstruction, and these will soon be supplemented by loans from the International Bank.

I do not believe that the measures which have been taken and the new international institutions that have been set up are cure-alls that will overcome the many difficulties in the field of international finance. I do believe that they offer a practical approach to a solution of our problems.

We must proceed now to manage our own affairs with care and diligence and to participate to the best of our ability in carrying out the operation of the new international machinery which we have helped to establish. Only

in this way can we enable our own industries, our farmers and our miners to find satisfactory export markets over the years to come. In this way I think lies the best chance of Canada continuing to enjoy peace and prosperity.

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## National Income and Expenditure in Britain During the War Years

By Samuel Hays, B.Com., Hon. F.S.S.  
London, England

MUCH has been said, and written, of the high degree of mobilization achieved by Britain for the purpose of prosecuting the war. At any time during the period 1939-45, it was possible to present some statistical evidence as to the extent of this mobilization. With the publication, in April, of the government White Paper on Britain's finances, it is now feasible, for the first time, to review statistically the whole war period and to appreciate the progressive increase in the national income and the ever increasing portion devoted to war purposes. It will be recalled that, beginning with the 1941 budget, the Chancellor of the Exchequer has issued each year a White Paper giving an assessment of the nation's income, facts about taxable incomes, government expenditure, changes in consumption, and so on. It is mainly, but not entirely, to the White Paper of April 1946 that the following tables are owed. Evidence has, in a number of cases, however, been obtained from other sources.

The national income and expenditure can, of course, be studied from a number of angles. In order to present as complete a picture as possible within the limits of a short article, it will be convenient to review the available information under the following headings: (1) The National Income or Product and its Composition. (2) Changes in the Output per Person Employed. (3) Disposal of Private Income. (4) Changes in Consumption. (5) Distribution of Private Incomes. (6) Public Expenditure. (7) The Cost of the War and the Methods of Meeting this Cost.

### The National Income and its Composition

The concept of the national income is a somewhat complex one. It is, in fact, a fourfold idea, but the four different definitions which can be attached to the concept are all related to each other by the addition or subtraction of some particular factor. We begin with "personal income before tax" which is the sum of the personal incomes of all the individuals in the country. To this concept, can be added the undistributed income of joint-stock companies together with other non-personal incomes, to give idea number two—"private income before tax". Basically, however, there is an element of duplication in this latter figure since it includes incomes derived from pensions and other payments made by the state out of the proceeds of taxation. When these "transfer" payments which have no compensating effect on current effort have been deducted, the resultant amount is called, in the White Paper, "private income from current economic activity". To this is added revenue accruing to the government from property, industrial and trading enterprises in public hands, etc., to give

TABLE I  
National Income and Product  
(in £'s millions)

Source	1938	1940	1942	1944	1945
1. Personal income before tax	4,772	5,720	7,087	8,019	8,351
2. + Other private income before tax .....	259	615	962	975	900
3. Private income before tax	5,031	6,335	8,049	8,994	9,251
4. — Transfer payments ....	475	484	581	724	891
5. Private income from current economic activity ..	4,556	5,851	7,468	8,270	8,360
6. + Public income from property, trading, etc. ....	54	71	132	131	123
7. Net national income at factor cost .....	4,610	5,922	7,600	8,401	8,483
8. + Sums allowed for depreciation and maintenance	475	505	520	520	520
9. Gross national product at factor cost .....	5,085	6,427	8,120	8,921	9,003
10. + Indirect taxes less subsidies .....	601	827	1,207	1,256	1,188
11. Gross national product at market value .....	5,686	7,254	9,327	10,177	10,191

a major concept, the third in our series—"net national income at factor cost". Sums allowed for depreciation and maintenance of capital equipment are not included in the income at factor cost. When this is added the "gross

national product at factor cost" is obtained. So far, no note has been taken of the effect of indirect taxation, local rates, etc. To give a concrete example, a packet of 20 cigarettes is only valued at 7d.—the cost of the wages, salaries, rent, interest, profits and import costs which went into it—in our definitions so far. When market prices are considered, the 20 cigarettes are reckoned at 2/4 since 1/9 is added by way of excise duties. The addition of indirect taxes less any subsidies, to the gross national product at factor cost, gives the fourth of our concepts—the "gross national product at market value". The actual figures taken directly from the White Paper are shown in table 1.

Perhaps the most useful of the foregoing figures is the net national income at factor cost. But it is the variation in its amount between 1938 and 1945 about which we are most concerned. Over the whole period the national income rose by 85 per cent. The rate of increase rose from 1939 to 1942 but declined thereafter. It is somewhat remarkable that the figure for 1945 should be in excess of that for 1944 since 1945 had but four months of total war and four and a half months free from hostilities. Doubtless the increase is made up of a rise in the first half not wholly cancelled by a fall in the second half of the year.

Not all the 85 per cent increase is a real one. Some of it is due to a rise in prices. There is a fair amount of evidence to show that the increase in average prices between 1938 and 1945 was of the order of 40 to 45 per cent. In other words, half the increase in the national income could be attributed to greater output and half to higher prices. When it is remembered that at the highest point of Britain's mobilization over 5 million persons were serving in the armed forces or engaged on full-time civil defence, this physical increase is remarkable. It was brought about by full employment of all males of working age, the recruitment of a large volume of female labour in which married women played a large part, and the unwearying exertions of all sections of the community. Hours of work were lengthened, three shift working became the rule, and production per man hour certainly increased, at least until the end of 1944.

The White Paper provides some very interesting information regarding the composition of the national income. Two sets of statistics must suffice in analyzing this; first,

# NATIONAL INCOME AND EXPENDITURE IN BRITAIN

the composition of the national income as regards the shares received by the various factors of production.

TABLE 2

National Income and the Factors of Production (in £'s millions)							
Factor	1938	(%)	1940	1942	1944	1945	(%)
Rent of land and buildings .....	380	(8.2)	388	384	384	385	(4.5)
Interest, profits and professional earnings	1,317	(28.5)	1,829	2,342	2,487	2,445	(28.8)
Salaries .....	1,100	(24.1)	1,206	1,381	1,473	1,585	(18.7)
Wages .....	1,735	(37.6)	2,115	2,688	2,890	2,840	(33.5)
Pay and allowances of armed forces ..	78	(1.6)	386	805	1,167	1,228	(14.5)
N.N.I. at factor cost	4,610	(100)	5,922	7,600	8,401	8,483	(100)

Perhaps the most noteworthy feature of table 2 is the fairly constant share of the national income which has been derived from interests, profits and professional earnings. There is no evidence here of the existence of inflated war profits. The freezing of rents at the pre-war figure is clearly indicated by the first line in the table. In spite of the fact that pay and allowances of the armed forces continued to account for an increasing share of the national income, the percentage taken by labour (wages) remained very constant until 1944 when, after D-Day, overtime was reduced somewhat.

Next, the proportions of the national income devoted to consumption, war purposes and capital formation for purposes other than war, provide a useful indication of the extent of Britain's mobilization for war purposes. At this stage it may be said that no other country devoted such a large proportion of its national income to prosecuting the war. In the last report to Congress on the progress of lend-lease, President Truman provided some comparative statistics. In the four years 1941-44 inclusive, Britain devoted 54 per cent of her national income to war purposes. From President Truman's report it appeared that in the three years 1942-44 inclusive U.S.A. expenditure on the war represented 42½ per cent of that country's income. Canada came about half way between Britain and U.S.A.

TABLE 3

Composition of the National Income (in percentages)					
	1938	1940	1942	1944	1945
Consumption including government non-war expenditure .	88	72	60	58	61
War purposes .....	7	44	52	54	49
Net non-war capital formation	5	-16	-12	-12	-10

MAY 1947.



The last line brings out clearly the extent of the realization of Britain's overseas investments and the incurring of overseas liabilities. The worst year was 1941 with —17 per cent. With the introduction of lend-lease this figure showed a downward tendency.

#### **Changes in the Output Per Person Employed**

For this purpose it is necessary to go back to the census of production for 1935 as a starting point. For the 7¼ million people employed in industries covered by the 1935 census, the net output for that year was £1,603 million, giving a net output per person employed of £222. In general net output per head tended to increase with the size of the firm. For firms employing between eleven and twenty-four employees the net output per person was £201; firms employing 8,000 persons showed a figure of £309. There was an extremely wide variation in the net output per person as between industries and occupations.

During the war there was, in general, a shift of employment from the industries with a low net output per person to those with higher outputs. Once the munitions industries were working up to reasonably full capacity, the average net output per person was in the neighbourhood of £450 per annum. Having regard to the net national income at factor cost and the number of persons in employment in 1945, the average for the whole country would be round about £400. Some 20 million or so people produced a net national income of £8,483 million. Not the whole of this increase can be put down to higher prices as we saw earlier in this description. It is fairly clear, however, although we have no figures yet to confirm it, that the output per person fell considerably during the latter part of 1945, perhaps by as much as 25 per cent. This fall can be ascribed to shorter hours, the suspension of three shift working in some cases, the disappearance of the war-time urge to high output, and the dislocation due to the changeover from a war to a peace economy.

#### **Disposal of Private Income**

In line 3 of table 1 figures of private income before tax are given. The disposal of this private income along the three main lines of expenditure is the subject of a table in the White Paper. Part of this table is reproduced below. It will be more convenient if percentages, rather than actual figures are quoted, but it should be remembered that in each

# NATIONAL INCOME AND EXPENDITURE IN BRITAIN

case 100 per cent represents private outlay including savings or private income before tax.

TABLE 4  
Percentage Disposal of Private Income  
(in percentages)

	1938	1940	1942	1944	1945
Consumers' expenditure at market value .....	83	71	62	59	61
Direct taxes .....	11	12	19	24	23
Private savings including undistributed profits .....	6	17	19	17	16
Private outlay .....	100	100	100	100	100

The above table calls for little comment. Direct taxes accounted for twice the proportion of private outlay in 1944 and 1945 as it did in 1938. The proportion of savings has greatly increased, whilst consumption expenditure has been reduced to three-quarters its former proportion of income.

## Changes in Consumption

By way of amplification of line 1 in table 4 some interesting information is obtained by amalgamating a number of tables given in the White Paper. The figures shown below are taken from the "Economist" but the basic material for the compilation of the table appears in the White Paper. This table shows how great has been the lack of clothing, footwear and household goods in Britain during the war. It will be noticed that in the case of increases in 1945 compared with 1938, the items are mainly those in which there is a high proportion of indirect taxation. The rate of this taxation has been greatly increased during the war. The increase in expenditure on travel and communication services can readily be explained by the breaking up of families which has taken place as a result of war conditions.

TABLE 5  
Changes in Consumption  
(in percentages)

	Proportion of total consumption by market value		Increase or decrease 1938/1945 at constant prices	Proportion of 1945 price due to indirect taxation
	1938	1945		
Food .....	29	26	-15½	- 8*
Alcoholic beverages .....	7	13	+12	55
Tobacco .....	4	10	+25	77
Rent and rates .....	12	10	+ 2	32
Fuel and light .....	5	5	- 1	2½
Furniture and furnishings .....	4	2	-72	17

# THE CANADIAN CHARTERED ACCOUNTANT

Hardware .....	2	1	-54	17
Other household goods .....	1	1	-21½	13
Footwear .....	2	2	-26	6½
Other clothing .....	9	8	-39½	8
Reading matter .....	1	2	+18	2
Private cars and running expense..	3	neg.	-81½	11½
Travel .....	4	4	+30	7
Communication services .....	1	1	+20	2
Entertainments .....	1	3	+46	34
Other goods and services .....	15	12	-32	20
Total .....	100	100	-15	19½

\*Net subsidy.

Table 5 is concerned with expenditure only. Alongside increases in prices has gone, in many cases, a deterioration in quality.

## Distribution of Private Incomes

Under this heading some facts about the social revolution which has been taking place in Britain during the last two decades, and which has been immensely speeded up during the war, are shown. The large scale redistribution of incomes by means of taxation has been in operation for some time now; its completion has been brought much nearer since 1939. In the period 1942-1944, no less than 36 per cent of private incomes have been taken as taxation—direct and indirect. Naturally, the direct taxation has fallen more heavily on the higher incomes. Less than one-fifth of the incomes of £10,000 and over was retained after the payment of direct taxes at the rates ruling in 1944. Table 6(a) shows the very great increase in the number of direct taxpayers which has been brought about as a result of war conditions. From 1942-1945, income tax was payable on incomes of over £110 in the case of persons with no dependents. Fewer than 1,000 people had net incomes of over £4,000 in 1944.

TABLE 6  
Distribution of Private Incomes

Private income before tax	Percentage of income before tax retained after deduction of tax	
	1938-39	1944-45
Under £250 .....	99.8	97.5
£ 250—£ 500 .....	97.1	86.9
£ 500—£ 1,000 .....	88.9	73.4
£ 1,000—£ 2,000 .....	83.0	62.8
£ 2,000—£10,000 .....	71.1	47.0
£10,000 and over .....	49.4	19.4

# NATIONAL INCOME AND EXPENDITURE IN BRITAIN

**TABLE 6(a)**

Numbers in Different Ranges of Net Income		
Range of income after tax	1938-39	1944-45
£ 150—£ 250 .....	4,500,000	7,400,000
£ 250—£ 500 .....	1,820,000	5,050,000
£ 500—£ 1,000 .....	450,000	830,000
£ 1,000—£ 2,000 .....	155,000	186,000
£ 2,000—£ 4,000 .....	56,000	33,050
£ 4,000—£ 6,000 .....	12,000	890
£6,000 and over .....	7,000	60
	7,000,000	13,500,000

## Public Expenditure

As a means of avoiding inflation, the British government had as its aim the raising of at least half the national expenditure from taxation. This involved the heavy tax burdens discussed in the last section. The extent of the success of this policy is revealed by Table 7.

**TABLE 7**  
Public Expenditure  
(in £'s millions)

	1938	1940	1942	1944	1945
Total cent. government expenditure	1,033	3,365	5,129	5,971	5,967
Of which: Revenue .....	885	1,275	2,366	3,218	3,268
Net borrowing .....	148	2,090	2,763	2,753	2,699
Percentage of revenue to total expenditure .....	86	38	46	54	55

As a measure of Britain's progress towards a balanced budget, the Chancellor of the Exchequer announced that in the present fiscal year he expects to provide over 18/- of each £1 of expenditure out of taxation.

## The Cost of the War and the Methods of Meeting This Cost

By defining the cost of the war as the expenditure on war purposes in excess of the amount so spent in 1938, it is possible to calculate the cost of the war. In general, the resources called for by the government to wage war can come from four sources. They may arise out of an increased national income, i.e., the total volume of goods produced may be greater than in peacetime. We have already seen the extent of this. The share of the national income devoted to civilian consumption may decrease and so set free a larger volume of resources for war purposes. Something has been said about this. Or, government expenditure on non-war purposes—social services and the like—may be reduced, leaving a larger sum available for war finance. Lastly, smaller sums may be set aside for the

maintenance of the existing capital equipment and for the provision of new capital. This last stage may go still further and involve not only the realization of assets held abroad but also the incurring of foreign loans. Table 3 gave some general indication of this. Table 8 brings many of these points together. It may be of interest to note that the peak year in Britain was 1943; thus figures are given for this year, and for the whole period 1938-45. The total cost of the war from 1938 to the end of 1945, in terms of 1938 prices, was £16,850 million or a sum equal to three times the 1938 gross national product. By way of comparison table 8(a) shows how the war effort was financed in U.S.A. in 1944, the peak year of that country's war mobilization.

TABLE 8  
The Cost of the War  
(in £'s millions)

	1943		1945		1939-45	
	At 1938 prices	%	At 1938 prices	%	At 1938 prices	%
Cost of the war .....	3,140	(100)	2,900	(100)	16,850	(100)
Derived from:						
Larger output .....	1,325	(42½)	1,325	(45½)	6,710	(40)
Smaller consumption	735	(23½)	480	(16½)	3,430	(20)
Smaller government non-war expenditure .....	65	(2)	40	(1½)	275	(1½)
Reduced provision for domestic capital..	600	(19)	570	(19½)	3,365	(20)
Larger drafts on overseas capital..	410	(13)	485	(17)	3,070	(18½)

TABLE 8(a)  
Cost of the War in U.S.A. and Britain  
(in percentages)

	U.S.A. (1944)	U.K. (1943)
Larger output .....	100	42½
Smaller consumption .....	17	23½
Smaller government non-war expenditure ..	3	2
Reduced provision for capital .....	14	32
	<u>100</u>	<u>100</u>

In spite of the fact that Britain's manpower was more highly mobilized than that of any other country, only 40 per cent of the cost of the war was met by increased output, whereas the whole of the U.S.A. war expenditure was met in this way. Consumption actually increased in U.S.A.—

at the expense of other government expenditure and provision for capital. There was a much greater industrial slack for the United States to take up, but at the same time we must not underestimate the increased output per man-hour which took place in U.S.A. Nonetheless, financing a war out of increased output is a much less painful process than by having to reduce consumption and by realizing foreign assets.

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## Provincial News

### Quebec

The annual dinner of The Institute of Chartered Accountants of Quebec was held at the Windsor Hotel, Montreal, on Thursday, March 27th, with an attendance of six hundred members and guests. Mr. Frank E. H. Gates, the President, was in the Chair.

Mr. A. Emile Beauvais introduced the guest speaker, The Honourable Douglas C. Abbott, K.C., M.P., Minister of Finance, whose address appears in this issue, and Mr. T. V. Burke thanked Mr. Abbott for his most interesting and enlightening address.

The Honourable Mr. Justice O. S. Tyndale spoke in response to a toast to the guests proposed by Mr. C. N. Knowles.

Prizes and Medals awarded to top-ranking candidates in the December, 1946, examinations were presented to the following: Marcel Hurtubise, Institute Gold Medal and Cash Prize for highest standing in the Final Examination. Mr. Hurtubise, also obtained highest standing in Canada, and won the Gold Medal and Cash Prize awarded by the Dominion Association of Chartered Accountants. The presentation was made by Mr. C. F. Elderkin, Immediate Past President of the Association. William Reay received the Institute's Cash Prize for second highest standing in the Province. For highest standing in the Intermediate Examination, Edward L. Irwin received the Institute's Silver Medal and Cash Prize, and Norman Sivkin was awarded a Cash Prize for second highest standing in the Province.

**LEGAL DECISION RESPECTING THE INCOME WAR  
TAX ACT OF CANADA.**

**DEDUCTIONS—LEGAL EXPENSES**

The Hudson's Bay Company, Appellant

—and—

The Minister of National Revenue, Respondent

(The Exchequer Court of Canada, Angers, J., 21st February 1947)

In its income tax returns for the years 1938 and 1939 the appellant claimed as allowable expenses the sums of \$10,377 and \$22,953 expended in those years in respect of the prosecution of a suit brought by it in the United States District Court, Western District of Washington, against the Hudson Bay Fur Company of Seattle. The appellant sought and secured an injunction restraining the Seattle company from using the words "Hudson" and/or "Bay" or any other words or mottoes which would lead customers to believe that the Seattle store was a branch or affiliate of the Hudson's Bay Company. The Minister disallowed these items under section 6(b) of the Act, claiming they were outlays on account of capital. The evidence indicated that a substantial proportion of the American customers were under the impression that the Seattle company was affiliated with the appellant and as a result, considerable business was lost to the appellant, particularly to their Pacific coast stores. A professional accountant, testifying at the trial, stated that, in his opinion, such outlays were attributable to working expenses rather than to capital.

HELD: After reviewing the judgments of a number of cases covering the allocation of outlays as between income and capital, the judgment concluded as follows:

"The costs and expenses laid out by the appellant to prevent the Hudson Bay Fur Company, of Seattle, from using a firm name so closely resembling its own that it misled many American tourists and induced them to believe that Hudson Bay Fur Company was a branch or subsidiary of the appellant and to thereby turn to the appellant company the profits or gains derived by Hudson Bay Fur Company from sales made to purchasers believing that they were dealing with the appellant must, in my judgment, be considered as disbursements or expenses laid out and expended for the purpose of earning the income as prescribed in paragraph (a) of subsection 1 of section 6 of the Income War Tax Act. These costs and expenses were not laid out with the object of acquiring or bringing into existence an asset; they were made in the ordinary course of preserving and maintaining the trade of the appellant and safeguarding it from the diversion thereof by a party misusing the appellant's name. I do not believe that these costs and expenses can be considered as a capital outlay.

I do not think that the assertion set forth by counsel for respondent that the costs and expenses in question constitute an expenditure made once and for all for the enduring benefit of the trade is founded.

The argument made on behalf of respondent that the appellant in taking proceedings against Hudson Bay Fur Company had acquired part of the latter's goodwill, since it had been in business for approximately thirty years, apart from the fact that it is not mentioned in the pleadings, is not, to my mind, serious. The action was taken after long and protracted negotiations had been carried on, when it was seen that no solution could be obtained otherwise.

I have already stated that the respondent's contention that the costs and expenses in question, if deductible from the profits and gains of the appellant, must be deducted from the profits and gains of the



## BOOK REVIEWS

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American subsidiary, viz. Hudson's Bay Company Inc., of New York, or, if it cannot be done, from those of the appellant's business in Great Britain, is, to my mind, ill-founded seeing that the business of appellant which was affected by the illegal trade of Hudson Bay Fur Company was the Canadian section thereof.

After a careful perusal of the evidence and of the able and comprehensive argument of counsel and an elaborate study of the precedents, I have reached the conclusion that the legal costs and expenses in question amounting to \$10,377 and \$22,952.80 paid by the appellant in its fiscal years ending January 31, 1938, and January 31, 1939, respectively must be considered as disbursements or expenses wholly, exclusively and necessarily paid out for the purpose of earning its income and that they are not an outlay, loss or replacement of capital.

There will accordingly be judgment in favour of the appellant maintaining the appeal, setting aside the decision of the Minister and the notices of assessment for the years 1938 and 1939 and declaring that the sums of \$10,377 and \$22,952.80 must be deducted from the income of the appellant for its fiscal years ending January 31, 1938 and January 31, 1939, respectively.

The appellant will be entitled to its costs against respondent."

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## BOOK REVIEWS

**Everyman's Guide to Canada's Parliament.** By George Hambleton—World Affairs Press Ltd., 224 Bloor Street West, Toronto, 63 pages, 75 cents.

This is an interesting booklet giving a short history of parliaments, how they came to be, what our Canadian parliament is and how it works. It gives information on the composition and responsibilities of the cabinet, of the manner of election to parliament of the members and of the various parties and leaders. There is a chapter on the Press Gallery and it concludes with a glossary of terms commonly used and heard when discussing parliamentary procedure.

**A Digest of Income Tax Cases.** By Molyneux L. Gordon, K.C., Mundy-Goodfellow Printing Company Limited, 100 Adelaide Street West, Toronto.

Mr. Gordon, who has long been particularly interested in income tax matters in Canada, has reproduced in this volume summaries of the decisions given in income tax cases of the British Commonwealth of Nations and the principal subdivisions thereof during the years 1942 to 1945. In an appendix there is reproduced the section of the law which was applicable to each of the cases dealt with. The cases are arranged under subject headings and also indexed alphabetically for ready reference.

This digest will be a most useful addition to one's library of income tax decisions.

## Current Accounting Literature

By Frank S. Capon, C.A.  
Montreal, P.Q.

### Aims of Cost Accounting

"What cost accounting means to a production executive" is the title of an article by W. K. Bailey in the 15th March N.A.C.A. Bulletin. The main emphasis is on the present and future cost figures—what production is costing now and what it will cost, not what it did cost. Historical costing has its importance, particularly as a gauge of efficiency, but interpretation of cost trends, estimated cost of new products, and estimated future costs of existing products, the author claims, are of much greater importance.

### Accountants' Part in Increasing Productivity

According to the article by W. H. Franklin in the same bulletin, accountants have a vital role in increasing productivity or obtaining greater output per dollar of labour costs. They must study and analyze the cost of alternative methods of performing the various production tasks, or they must endeavour to point the way to increased productivity without changes in present methods by time and motion studies, improved procedures and working conditions, educating workers, and avoiding confusing terminology.

### Budgetary Control of Expenses

J. B. Heckert, of Ohio State University, has contributed an excellent article on budgetary control in the 15th March N.A.C.A. Bulletin. The author discusses the method of initiating a budgetary policy, the need of co-operation of all units, the co-ordination of effort, as well

#### PUBLICATION ADDRESSES, AND PRICE PER COPY POSTPAID

Accountancy, Incorporated Accountants' Hall, Victoria Embankment, London, W.C. 2, England. 1 shilling.  
Accountants' Magazine, 28 Rutland Square, Edinburgh, Scotland. 1s. 3d.  
Accounting Review, School of Commerce, Northwestern University, Evanston, Ill., U.S.A. \$1.  
The Accountant, Moorgate Place, London E.C. 2, England. 1 shilling.  
The Controller, 1 East 42nd St., New York, N.Y. 50 cents.  
Cost and Management, 66 King St. East, Hamilton, Ont. 35 cents.  
Harvard Business Review, Harvard University, Boston, Mass., U.S.A. \$1.50.  
Journal of Accountancy, 13 East 41st St., New York, N.Y. 35 cents.  
The Internal Auditor, 29 Atlantic Street, Stamford, Conn., U.S.A. \$1.  
National Association of Cost Accountants, 385 Madison Ave., New York. 75 cents.  
Taxes—The Tax Magazine. CCH Canadian Limited, 31 Whitecocks St., Toronto, Ont. \$6.00 per year. (American Publication).

as the mechanics of budget preparation. Problems affecting variable costs, semi-variable costs, and fixed costs are also reviewed and the article includes a summary of the types of expense normally classified under each head.

#### **Controllers Institute Pamphlets**

A number of pamphlets have been published by the Controllers Institute of America, including such titles as "Controllershship problems in distribution", "Fiscal and economic problems and policies", "Controllers' reports to top management" and "The Controller's interest in public relations". It is not possible to summarize such pamphlets in this limited space, but the titles are self-explanatory. Each pamphlet includes several papers on the subject by top-ranking financial executives, and all senior industrial accountants would do well to obtain copies of the entire set of pamphlets.

#### **Audit Reports**

Concluding with the thoughts that accounting bodies will have to carry out far more extensive research because of risks incurred in certifying to modern statements, and that more audit certificates will have to be qualified, Mr. Bertram Nelson has contributed a brief article on audit reports in the 15th February issue of "The Accountant". The author's main point is that the scope of an audit must always be as broad as the certificate indicates, and that the brief, clean certificate may indicate that the accountant is an expert on inventory valuation, depreciation adequacy, and other technical problems.

#### **Financial Statements for Corporate Reports**

The March issue of the "Journal of Accountancy" contains a long article by W. Blackie on the history of the development of the financial statements included in the annual reports of "Caterpillar Tractor Company". This Company has made an outstanding effort to provide adequate financial information for owners and employees by drawing up financial statements in "colloquial" form, and providing long term comparisons. While many accountants disagree with the result, and most agree that there is nothing radically new in single column balance sheets, the thinking behind Caterpillar's terminology is worthy of serious consideration. In times when we all acknowledge a crying need to get better and more adequate information

into the minds of the masses we cannot afford to overlook such articles.

#### **Events Subsequent to Year-end**

Accounting statements purport to show results for a stated period or the financial position at a given date, but there has always been an absence of agreement on the extent to which events occurring after the close of the period should be disclosed or taken into account in accounting statements. Carman G. Blough, in another outstanding article in the March "Journal of Accountancy" discusses this problem, and reaches the conclusion that accountants should insist on the correction of statements for subsequent changes which belong in the accounting period under review, and should insist on disclosure of significant developments which belong in future accounting statements, or the nature of which is such that they cannot be reflected in financial statements in spite of their important effect on future operations.

#### **Accounting for UNRRA**

Another highly specialized type of financial control and accounting system is discussed by H. E. Howell, Controller of UNRRA in his article on "Financial Control of Operations and Accounting for UNRRA" in the March "Journal of Accountancy". After dealing with the agency's resources, budgets, financial controls, and operations, the Controller gives a statement of the funds received and expended by UNRRA.

#### **Trends in Corporate Annual Reports**

Mother Goose reports come in for some searching review in G. C. Ludolph's article on trends in corporate annual reports in the March issue of "The Controller". There has been a marked trend towards "popularization" of annual reports, both in respect of format and content, and the nursery rhyme approach to accounting terminology is becoming widespread. Do we presume that the comparative silence of the accounting profession on the subject indicates agreement?

#### **Explaining the Facts to Employees**

If we accept Keith Powlason's claim that there would be fewer strikes and other dislocations in relations between management and employees if industrial workers knew and

understood the facts of business life, we acknowledge that accountants have fallen down on their job of producing reports and statements that can be intelligently read and appreciated by the layman with an average education. The author's lengthy article in the March issue of "The Controller" discusses the problem and offers some tangible suggestions to management.

#### **Co-operatives and Taxation**

Since the problem of taxation of co-operatives is by no means solved, those interested in it should read the article on farmer co-operatives in the March issue of "Taxes". The purchasing and marketing co-operatives of farmers are discussed at some length by P. J. Foley, who reaches the conclusion that such co-operatives do not earn profits and are necessary for the prosperity of farmers.

#### **Accounting Principles**

The January issue of "The Accounting Review" contains a reprint of the statement by the American Accounting Association on accounting principles underlying corporate financial statements, with a request that readers send in any comments on necessary revisions to the statement. It is not possible to summarize such a statement, every word of which has been chosen with great care, but all active accountants should review this statement at least once each five years or so. One tends to get out of touch with the basic fundamentals when bowed down with the weight of day to day pressure.

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### **Personal**

Pat N. Goode, C.A., of 70 Wellington Street North, Sherbrooke, wishes to announce that he has opened an office at 7 Young Street, Granby, which will be under his personal supervision.

**REGINA CHARTERED ACCOUNTANTS' CLUB  
MARCH LUNCHEON**

Mr. R. C. Field of Victoria, Dominion President of our Association, was guest speaker at the Regina Chartered Accountants' Club March luncheon. C. H. Smith, C.A., Provincial President, was chairman of the meeting. Mr. Field gave a most interesting paper covering recent work of the Dominion executive with particular reference to examinations. Miss Janet Robinson expressed the thanks on behalf of the gathering to Mr. Field.

Mr. P. C. DeRoche, C.A., of Saskatoon, and Mr. E. C. Gerry, C.A., secretary of the Saskatchewan Institute from Prince Albert, were visitors at the function. Mrs. C. H. Smith was hostess to the wives of the Regina members at a tea during the afternoon in honour of Mrs. Field.

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Reg. Hodsman, C.A., was guest speaker at the Regina Chartered Accountants' Club April meeting. His subject was Machine Accounting which he covered in considerable detail and left the members with much "food for thought". Mr. A. M. Goldie, C.A., chairman of the meeting, tendered the thanks of the club to Mr. Hodsman for his efforts in preparing such an informative address.

## STUDENTS' DEPARTMENT

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J. E. SMYTH, C.A., Editor

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### NOTES AND COMMENTS

We suggest that any discussion of the advisability of restricting accounting apprenticeship to university graduates must eventually be argued against a background of what universities attempt to accomplish.

In this regard, an article in the March 1947 issue of *The Commerce Journal* (University of Toronto Commerce Club) seems relevant. We refer to *The University and Commerce and Finance* by Professor C. A. Ashley. "Some professors," writes Mr. Ashley, "are concerned that students should have placed before them every last bit of information available on their subject, under the extraordinary misapprehension that if they do not learn it now, they will never learn it . . . . A student who leaves the university unacquainted with the classics of his own language; unable to tell a good picture from a bad one; ignorant of music except for the latest dance rhythm; uninterested in politics; unaware of philosophy; seeking relaxation by rushing from one place to do nothing of significance in another;—such a student has wasted his opportunities." He quotes one thinker concerned with the problems of education who has said, "Civilization has had to await the beginning of the twentieth century to see the spectacle of how brutal, how stupid, and yet how aggressive is the man learned in one thing and ignorant of all else."

A worthy contemporary of *The Commerce Journal* is *The Commerceman* (Journal of the Queen's Commerce Club). In the Spring 1947 issue, another aspect of the situation is considered: the advisability of university graduates entering the accounting profession! In *Chartered Accountancy as a Post Graduate Programme* the readers of this Department will be pleased to recognize the voice of its former editor. "Chartered accountancy," writes Professor Smalls, "is an ideal course for those to pursue who are determined that their training and equipment shall be as good as any and better than most." But, a little later, "A special word of warning should be issued to the



married graduate because unless the wife is as enthusiastic as the husband, a career in chartered accountancy might well wreck the home . . . . It should be placed on record to their great glory that wives have existed who bore all [the consequences] cheerfully for the four or five years involved and emerged unscathed in both temperament and looks at the end of the ordeal."

\* \* \*

For the benefit of any of our readers who did not attempt Problem I in the March Students' Department (as well as for any who may usefully be reminded of it) we take the liberty to draw a moral from that question: where one is asked to appraise the relative merits of alternative proposals for further financing (viz., issue of bonds vs. issue of preferred stock vs. issue of common stock), he should not forget that the issue of bonds will tend to reduce income and excess profits taxes by introducing an allowable expense—bond interest. The same would be true for interest on a bank loan, but not, of course, for dividends on preferred and common stock.

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#### STUDENTS' ASSOCIATION NEWS

##### Ontario

At a recent meeting of the Students' Council, committees were formed to make arrangements for the annual meeting, for nominations and election of officers for the coming year, and for making arrangements for renewal of the inter-office softball league.

Since that meeting it has been announced by the committee in charge that the annual meeting is to be held Monday, May 12, 1947 in the theatre of the Royal Ontario Museum, Toronto. Refreshments are to be served, a speaker has been engaged and several students have prepared a skit to insure an interesting evening. Important additions to the by-laws are to be discussed and all members are urged to attend.

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#### PROBLEMS AND SOLUTIONS

##### THE PROVINCIAL INSTITUTES OF CHARTERED ACCOUNTANTS

Solutions presented in this section are prepared by practising members of the several provincial Institutes and represent the personal views and opinions of those members. They are designed not as models for submission to the examiner but rather as such discussion and

## STUDENTS' DEPARTMENT

explanation of the problem as will make its study of benefit to the student. Discussion of solutions presented is cordially invited.

### PROBLEM I

#### INTERMEDIATE EXAMINATION, DECEMBER 1946

##### Accounting I, Question 5 (15 marks)

You are the accountant of the A.B.C. Manufacturing Company whose general ledger discloses the following fixed asset accounts at 31st December 1944:

Land .....	\$100,000	
Building .....	400,000	
Reserve for depreciation of building .....		\$ 90,000
Machinery .....	200,000	
Reserve for depreciation of machinery .....		180,000

No additions have been made to building or machinery since acquisition on 1st January 1936. Depreciation has been charged at 2½% on building and 10% on machinery.

On 1st July 1945 two machines, costing \$6,000 and \$3,000 respectively, were considered obsolete and realized a scrap value of \$500 and \$200. They were replaced by two machines costing \$10,000 and \$5,000.

The management has requested you to increase the book value of land from cost to an approximate valuation of \$150,000 in accordance with current real estate values. The building has been appraised by an independent appraisal company at \$450,000, (replacement cost, less observed depreciation) and the management also requests that this valuation be shown on the books.

*Required:*

- (a) Give the necessary journal entries to record the transactions.
- (b) Comment, where necessary, on the management's request in regard to appreciation.

### SOLUTION

#### A.B.C. Manufacturing Co. — Journal

1. Depreciation of machinery .....	\$ 450.00	
Reserve for depreciation of machinery (10% on \$9,000.00, 6 mos.)		\$ 450.00
2. Reserve for depreciation of machinery....	8,550.00	
Machinery .....		8,550.00
(Write off reserve on machines sold)		
3. Cash .....	700.00	
Machinery .....		700.00
(Sale of scrapped machinery)		
4. Machinery .....	250.00	
Profit and loss .....		250.00
(Profit on sale of machines)		
5. Machinery .....	15,000.00	
Cash .....		15,000.00
(Purchase of machinery)		
6. Land .....	50,000.00	
Capital surplus from appraised valuation (Increase from cost \$100,000.00 to appraised value—\$150,000.00)		50,000.00
7. Reserve for depreciation of building ....	90,000.00	
Building .....		90,000.00
(Write off of depreciation reserve)		
8. Building .....	140,000.00	
Capital surplus from appraised valuation		140,000.00

## THE CANADIAN CHARTERED ACCOUNTANT

(Increase to appraised value of building  
from net book value \$310,000.00 to ap-  
praisal of \$450,000.00)

The land should not be increased to conform with current real estate valuations as no justification can be found for enhancing the value due to market conditions, unless sale is contemplated. It would also seem that the management were unwise in increasing the book value of the building to the appraised valuation as only nine years depreciation had been charged and a considerably large net book value is shown. If the building had been considerably depreciated the move might be justified. However, as the appraisal was made by an independent appraisal company and the management is adamant the increase must be credited to a special surplus account and properly designated on the balance sheet.

### PROBLEM II

#### FINAL EXAMINATION, DECEMBER 1946

##### Accounting I, Question 2 (35 marks)

The post closing trial balance of The Experimental Chemical Company Limited at 31st December 1945 was as follows:

	Dr.	Cr.
Cash on hand and in bank .....	\$ 2,200	
Accounts receivable .....	24,326	
Inventories .....	37,650	
Other current assets .....	1,237	
Land and buildings .....	87,500	
Plant and equipment .....	229,627	
Office equipment .....	2,735	
Formulae and processes .....	50,000	
Bank loan .....		\$ 22,000
Accounts payable .....		17,075
Accrued charges .....		2,750
Reserves for depreciation:		
Building .....		11,250
Plant and equipment .....		27,630
Office equipment .....		2,130
Reserve for doubtful accounts .....		4,200
Common stock, no par value .....		200,000
7% cumulative preferred stock—		
\$100 par .....		175,000
Deficit .....	26,760	
	\$462,035	\$462,035

The company was originally incorporated 1st July 1937 by James Gregg and Robert Dick each of whom subscribed for 50% of the authorized common stock. The capitalization of the company consisted of 1,000 shares of common stock of \$100 par value and 1,000 shares of 7% cumulative preferred stock of \$100 par value. As consideration for the purchase of the common shares Gregg transferred to the company certain formulae and processes which were set up on the books at the par value of the stock. Dick transferred to the company a factory building as consideration for the purchase of his common shares. This building was also recorded on the books at the par value of the stock issued for it. All of the preferred shares were sold to outsiders at par.

On 1st January 1940, in order to secure further capital to finance the construction of larger plant facilities, the company obtained sup-

## STUDENTS' DEPARTMENT

plementary letters patent authorizing the issue of a further 750 shares of preferred stock of \$100 par value while the common stock was cancelled and replaced by 8,000 shares of no par value. The preferred stock was all immediately issued for cash at par. The existing holders of common stock received four shares of the new common stock for each old share, the new stock being set up on the books at a value of \$25 per share. Gregg and Dick each purchased one share of the new common stock for \$25 cash, in order to maintain control. The balance of the new stock was sold to the public at \$30 per share, the directors having determined that \$25 should be credited to capital and the balance of \$5 to distributable surplus.

Operations, however, were not as successful as had been anticipated and by 31st December 1945 the directors had decided to explore the possibilities of eliminating unpaid preferred dividends which had accumulated since 1st January 1943 and of writing down certain inflated asset values. In this connection they ask you to prepare for them a statement showing the sources from which funds have been derived and the purposes for which they were expended during the period from the Company's inception to 31st December 1945.

You are also given the following information:

(a) Common stock dividends were paid as follows:

31st December 1938—	\$8 per share
31st December 1939—	\$8 per share
31st December 1940—	\$2 per share
31st December 1941—	\$1 per share
31st December 1942—	\$1 per share

(b) During 1938 and 1939 the formulae and processes account was reduced by charges to operations totalling \$20,000. In 1942 certain of the processes were sold for \$5,000 which was credited to formulae and processes account.

(c) In 1940 the original building was sold for \$55,000. At the time of the sale the total depreciation reserve applicable to this building amounted to \$2,500.

**Required:**

Prepare the statement requested by the directors.

### SOLUTION

#### THE EXPERIMENTAL CHEMICAL COMPANY LIMITED

STATEMENT OF SOURCE AND APPLICATION OF FUNDS  
for the period July 1, 1937 to December 31, 1945

Funds derived from:

#### Earnings

Net profit on operations for the period (Schedule I) .....		\$ 48,000.	
Add: Operating charges not involving an outlay of funds:			
Depreciation .....	\$ 43,510.		
Formulae written off .....	20,000.	63,510.	\$111,510.

Sale of non-current assets—

Building .....	\$ 55,000.		
Formulae and processes .....	5,000.	60,000.	

Sale of capital stock—

Preferred stock .....	\$175,000.		
No par value common stock—			

# THE CANADIAN CHARTERED ACCOUNTANT

Credited to capital .....	\$100,000.		
Credited to distributable surplus .....	19,990.	119,990.	294,990.
			<u>\$466,500.</u>
<b>Funds applied to:</b>			
Working capital (Schedule II) .....			\$ 19,388.
Payment of dividends			
On common stock .....	\$ 48,000.		
On preferred stock .....	54,250.	102,250.	
Purchase of non-current assets			
Land and buildings .....	\$ 87,500.		
Plant and equipment .....	229,627.		
Office equipment .....	2,735.		
Formulae and processes .....	25,000.	344,862.	
			<u>\$466,500.</u>

## Schedule I

### THE EXPERIMENTAL CHEMICAL COMPANY LIMITED STATEMENT SHOWING AGGREGATE NET PROFIT FROM OPERATIONS for the period July 1, 1937 to December 31, 1945

Deficit, December 31, 1945 .....		\$ 26,760.
Add: Credit to surplus arising out of issue of no par value stock .....	\$ 19,990.	
Profit on sale of building .....	7,500.	27,490.
		<u>\$ 54,250.</u>
Less: Dividends paid—		
Common .....	\$ 48,000.	
Preferred .....	54,250.	102,250.
Net profit from operations for the period .....		<u>\$ 48,000.</u>

## Schedule II

### STATEMENT OF WORKING CAPITAL POSITION as at December 31, 1945

<b>Current assets</b>		
Cash on hand and in bank .....	\$ 2,200.	
Accounts receivable .....	\$ 24,326.	
Less: reserve for doubtful accounts ....	4,200.	20,126.
Inventories .....	37,650.	
Other current assets .....	1,237.	\$ 61,213.
<b>Less: Current liabilities—</b>		
Bank loan .....	\$ 22,000.	
Accounts payable .....	17,075.	
Accrued charges .....	2,750.	41,825.
Net working capital, December 31, 1945..		<u>\$ 19,388.</u>